82-658

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No. 82-

In the Supreme Court of the United States

OCTOBER TERM, 1982

CONSOLIDATED SERVICE CORPORATION,
WATTS DETECTIVE AGENCY and
CHRISTOPHER P. RECKLITIS,
PETITIONERS,

v.

ROBERT ROBINSON, TRUSTEE IN BANKRUPTCY
OF D.C. SULLIVAN & CO., INC.,
RESPONDENT.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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Blanchard Press, Inc., Boston, Mass.—Law Printers

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Questions Presented For Review

1. Under Fed. R. Evid. 609(a), is evidence of a party/witness's prior criminal conviction admissible for impeachment purposes on direct examination by the opposing party even though Rule 609(a) limits such evidence to cross examination only?

2. Did former Rule 43(b) of the Federal Rules of Civil Procedure, abrogated effective July 1, 1975, govern the admissibility of evidence at a trial held in March 1980?

3. Is it a transfer of property within the meaning of the fraudulent transfer provisions of section 67d(2)(a) of the Bankruptcy Act to hire an officer and the at-will employees of a defunct business, and to commence servicing most of the business' former customers?

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ROBERT ROBINSON, TRUSTEE IN BANKRUPTCY
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RESPONDENT.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

The Petitioners Consolidated Service Corporation, Watts Detective Agency and Christopher P. Recklitis[1] respectfully pray that a writ of certiorari issue to review the judgment of the United Stated Court of Appeals for the First Circuit entered in this proceeding on July 19, 1982.

[1] In addition to the parties listed in the caption hereof, the parties to the proceeding below included Daniel C. Sullivan and Billy R. Otte.

Opinion Below

The opinion of the United States Court of Appeals for the First Circuit is reported at 685 F.2d 729 (1st Cir. 1982), and is duplicated at Appendix pages A-1 through A-25.

Jurisdiction

The judgment of the United States Court of Appeals for the First Circuit was rendered and entered on July 19, 1982. Petitions for rehearing were filed by petitioner Christopher P. Recklitis on July 30, 1982, by Daniel C. Sullivan on August 2, 1982, by Robert Robinson, Trustee, on August 2, 1982, and by Billy R. Otte on August 6, 1982. All petitions for rehearing were denied by Orders entered on September 14, 1982. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

Statutes And Rules Of Court

BANKRUPTCY ACT, section 67d(2)(a), former 11 U.S.C. section 107d(2)(a) (1970):

> Every transfer made and every obligation incurred by a debtor within one year prior to the filing of a petition initiating a proceeding under this title by or against him is fraudulent (a) as to creditors existing at the time of such transfer or obligation, if made or incurred without fair consideration by a debtor who is or will be thereby rendered insolvent, without regard to his actual intent....

FED. R. EVID. 609(a):

> *General rule.* For the purpose of attacking the credibility of a witness, evidence that he has been con-

victed of a crime shall be admitted if elicited from him or established by public record during cross-examination but only if the crime (1) was punishable by death or imprisonment in excess of one year under the law under which he was convicted, and the court determines that the probative value of admitting this evidence outweighs its prejudicial effect to the defendant, or (2) involved dishonesty or false statement, regardless of the punishment.

Statement of the Case

1. *Statement of Facts*

In the late 1960's D.C. Sullivan & Co., Inc. ("the Bankrupt"), a security guard business, experienced rapid financial deterioration. Its customers decreased from 35 to 17 (A-71) and its disbursements exceeded receipts by nearly 50%. (A-71, 72).

By April 1970, the Bankrupt was deeply in debt to the IRS and others (A-3, A-73), and was unable to pay its debts as they became due (A-75).

In early 1970, Billy R. Otte ("Otte"), Vice President of the Bankrupt, discussed a possible sale of the Bankrupt with Christopher P. Recklitis ("Recklitis"), the president of Watts Detective Agency ("Watts") and Consolidated Service Corporation ("Consolidated")[2] (A-4). Recklitis made a number of proposals on behalf of Watts to buy the bankrupt as a going concern, subject to IRS approval (A-4, A-5). The highest offer was approximately $200,000 payable over several years and contingent on maintaining sales levels (*id.*).

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[2] Watts Detective Agency and Consolidated Service Corporation were subsequently directly or indirectly merged into SCA Disposal Services of New England, Inc., a wholly-owned subsidiary of SCA Services, Inc., a public corporation. SCA Services, Inc. has approximately 66 subsidiaries, all but four of which are wholly owned.

The IRS rejected each of Watts' proposals. The last meeting with the IRS ended at 5:00 p.m. on April 22, 1970 (A-5). At that time the IRS stated that it would levy on the Bankrupt's accounts receivable the next morning (*id.*), and it in fact did. (A-75).

The Bankrupt's accounts receivable were its only source of cash and it was admitted that as of 5:00 p.m. on April 22, 1970, no cash was or would be available to cover either payroll checks already issued or the weekly payroll for that week (A-75). In the words of its president, "the ship was going down."

Thereafter, Recklitis, on behalf of Watts, offered Otte a job and Otte accepted (A-5). As a Watts employee, Otte thereafter began approaching the Bankrupt's former customers to offer them Watts' services (*id.*). Watts also hired most of the Bankrupt's former guards.

Watts already knew the customers' identities (A-76). The only contract the Bankrupt had with any of its customers was terminable on 24 hours notice and neither Otte nor the guards had employment contracts. Watts ultimately serviced 13 of the 17 former customers. (A-5).

Watts did not receive any funds due to the Bankrupt, (A-77) nor did it use the Bankrupt's trade name.

On May 22, 1970, an involuntary bankruptcy petition was filed against the Bankrupt and it was adjudicated (A-77).

2. *Proceedings Below*

On October 6, 1970 the Trustee in Bankruptcy of the Bankrupt filed the Complaint herein in the United States District Court for the District of Massachusetts. He claimed, *inter alia*, that hiring the Bankrupt's former employees and servicing most of its former customers amounted to a fraudulent transfer of the Bankrupt's assets without consideration within one year of bankruptcy, under section 67d(2)(a) of

the Bankruptcy Act, former 11 U.S.C. § 107d(2)(a) (1970). Jurisdiction existed under section 67e of Bankruptcy Act, former 11 U.S.C. § 107e (1970).

In March 1980 the action was tried to a jury. In the intervening 9 years Recklitis' circumstances had changed: at the time of trial he had recently been convicted, and was incarcerated, on unrelated charges of mail fraud. The Trustee compelled his presence as a witness by writ of habeas corpus.[3] On his direct examination, over objection, the Trustee introduced evidence of Recklitis' criminal conviction for fraud, ostensibly for impeachment purposes. The Trustee vigorously exploited that evidence later in his summation.

The jury returned a verdict for the Trustee in the amount of $750,000 against all petitioners.

Watts, Consolidated and Recklitis then moved for judgment notwithstanding the verdict or for a new trial.[4] (A-29). Those motions were denied on August 28, 1981, (A-26) and Watts, Consolidated and Recklitis filed a notice of appeal from that judgment on September 25, 1981. The Trustee cross-appealed.

On July 19, 1982, the First Circuit affirmed the judgment against Watts, Consolidated and Recklitis in its entirety. It held that "the guards, customers and goodwill" were "property in a bankruptcy setting" and that in the aggregate they amounted to "the business itself," that "[t]he whole was greater than its parts." (A-8) It therefore concluded that by hiring Otte and the guards and servicing the customers Watts received property belonging to the bankrupt.

Recklitis, the Trustee and two co-defendants filed timely petitions for rehearing, which were denied on September 14, 1982 (A-62 - A-68).

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[3] None of the defendants, including Recklitis himself, sought such a writ.

[4] Defendants' motions for a directed verdict had been denied subject to later motions for judgment notwithstanding the verdict.

Reasons For Granting The Writ

I. The Decision Of The Court Of Appeals For The First Circuit Directly Overrules A Congressional Restriction On The Federal Courts.

The decision of the Court of Appeals for the First Circuit overrides a restriction on the use of prior conviction evidence which was deliberately imposed on the federal courts by Congress. Rule 609(a) of the Federal Rules of Evidence, as amended and approved by Congress, reads:

> *General rule.* For the purpose of attacking the credibility of a witness, evidence that he has been convicted of a crime shall be admitted if elicited from him or established by public record *during cross-examination* but only if the crime (1) was punishable by death or imprisonment in excess of one year under the law which he was convicted, and the court determines that the probative value of admitting this evidence outweighs its prejudicial effect to the defendant, or (2) involved dishonesty or false statement, regardless of the punishment. [emphasis added].

As part of his case-in-chief, the Trustee called Recklitis and introduced on direct examination, over objection, evidence of Recklitis' recent unrelated conviction. (A-18). The District Court and the First Circuit refused to follow the language of Rule 609(a) which specifically limits such evidence to cross examination.

Restricting introduction of such evidence to cross examination only was expressly required by Congress. The Supreme Court's original draft of Rule 609(a) had no such restriction:

> For the purpose of attacking the credibility of a witness, evidence that he has been convicted of a crime is admissible but only if the crime (1) was punishable by death or imprisonment in excess of one year under the law which he was convicted or (2) involved dishonesty or false statement regardless of the punishment.

Notes of the Committee on the Judiciary, House Rep. No. 93-650, quoted at 28 U.S.C.A. Fed. R. of Evid., Rule 609, at 284. The language limiting such evidence to cross examination was inserted by the Senate Committee on the Judiciary, Senate Report No. 93-1277, 28 U.S.C.A. Fed. R. Evid., R. 609, at 286.

Both the Senate and House Committees on the Judiciary were particularly concerned with the danger of unfair prejudice which this type of impeachment evidence by its nature entails. *Id.* Limiting such evidence to cross-examination was intended to limit the rule to witnesses who voluntarily take the stand and thus place their credibility in issue. That restriction is necessary, in a civil case, to prevent a party from calling an opposing party primarily to bring the highly prejudicial evidence of an unrelated conviction before the jury.

The First Circuit's decision eviscerates that congressionally-imposed restriction. The court reasoned that Federal Rule of Civil Procedure 43(b) (abrogated effective July 1, 1975) governs this case, and that it allows a party to call an adverse party as a witness and to "contradict and impeach him in all respects as if he had been called by the adverse party" (A-19). Then, citing Federal Rule of Evidence 607, which permits a party calling a witness to attack his credibility, it concluded that in a civil case a party may call an adverse party as a witness and then impeach him through evidence of a prior criminal conviction. (A-19). The First Circuit did not even discuss the clearly restrictive language of Rule 609(a).

The First Circuit's reliance on Fed. R. Evid. 607 is misplaced. Rule 607 is a general rule as to who may impeach, not as to what evidence is admissible to impeach. The rule reads, in its entirety, "The credibility of a witness may be attacked by any party, including the party calling him." The succeeding rules, Rules 608, 609 and 610, on the other hand, are detailed rules specifying the exact circumstances in which particular types of impeachment evidence may or may not be introduced. Merely because Rule 607 generally permitted the Trustee to impeach Recklitis does not mean that the district court could ignore the specific rule dealing with the particular method of impeachment used. If Rule 609 (as well as Rules 608 and 610) does not limit the manner in which a party may impeach "any witness," then it is meaningless, and none of its restrictions apply. Rule 607 should not be read to render the succeeding rules nullities.

The only other Circuit Court of Appeals which has addressed the question, the Ninth Circuit in *United States* v. *Dixon*, 547 F.2d 1079, 1082 n.2 (9th Cir. 1976), bypassed the congressional restriction on a different theory. It reasoned that all Congress intended was to prevent a witness who did not testify from being impeached by prior conviction evidence. The court relied on a single sentence of the legislative history, taken out of context, indicating that Congress understood that impeachment evidence is not admissible if a person does not testify.[5] However, even if the term "witness" in the rules could be

[5] That legislative history, in context, reads:

> One other clarifying amendment has been added to this subsection, that is, to provide that the admissiblity of evidence of a prior conviction is permitted only upon cross examination of a witness. It is not admissible if a person does not testify. It is to be understood, however, that a court record of a prior conviction is admissible to prove that conviction if the witness has forgotten or denies its existence.

Notes of Committee on the Judiciary, Senate Rep. No. 93-1277, quoted at 28 U.S.C.A. Fed. R. Evid., R. 609, at 286.

taken to include a nonwitness at trial — a dubious proposition at best — congressional choice of the phrase "cross examination" must have meant something less than *all* types of examination.

The decision of the First Circuit thus renders the Congressional act of inserting the phrase "during cross examination" into Rule 609(a) a meaningless exercise.

II. The First Circuit Erred Fundamentally In Holding That Former Rule 43(b) Of The Federal Rules Of Civil Procedure, Abrogated In 1975, Governed The Admissibility Of Evidence At Trial.

In affirming the District Court's decision to allow testimony as to Recklitis' criminal conviction into evidence, the First Circuit held:

> "Federal Rule of Civil Procedure 43(b) governs the mode of inquiry of this type of witness . . . ."

(A-19).

Former Rule 43(b) was abrogated nearly 5 years before the trial. The Order of the Supreme Court dated November 20, 1972, approved by Congress, Pub. L. 93-595, § 3, 88 Stat. 1926 (January 2, 1975), effective July 1, 1975, both adopted the Federal Rules of Evidence and abrogated former Fed. R. Civ. P. 43(b).

The District Court below did not rely on the abrogated rule, the Trustee did not urge its applicability on appeal, and the First Circuit did not explain why it should be applicable. Indeed, the First Circuit's reliance on both Fed. R. Civ. P. 43(b), which the Federal Rules of Evidence replaced, and various Federal Rules of Evidence is inherently inconsis-

tent. At the time of Trial Rule 43(b) had been abrogated for almost 5 years, and the Rules of Evidence had been in effect for that same period as its replacement.

The First Circuit's reliance on the long abrogated rule was such a clear and fundamental error that in itself it calls for correction.

III. The Decision Of The Court Of Appeals For The First Circuit Creates A Conflict In The Circuits.

The First Circuit's holding that hiring employees and servicing customers constituted a transfer of property conflicts with the holding of the Court of Appeals for the Fifth Circuit in *Trask* v. *Susskind*, 376 F.2d 17 (5th Cir. 1967), and is inconsistent with other applicable authority.

In *Trask* v. *Susskind*, the trustee claimed that a creditor caused the bankrupts to go out of business and then conspired with employees of the bankrupts "to transfer the goodwill and business customers of the bankrupts" to the creditor's corporation. *Id.* at 19.

In *Trask* the day after the bankrupts ceased doing business former employees of the bankrupts started soliciting former customers on behalf of their new employer, and approximately 50% of the bankrupts' former customers started doing business with the new company, in what the court acknowledged was a "very smooth" transition. 376 F.2d at 20. The District Court held that this was not sufficient to constitute a fraudulent transfer and the Fifth Circuit affirmed, holding that the trustee had not established "that the bankrupts had suffered any damage as a result of these activities." *Id.* at 20. The employees were not property of the bankrupts, the new corporation already knew the bankrupts' customers, and there was no transfer of goodwill, because "[o]rdinarily, goodwill cannot be transferred separate and apart from tangible assets . . . ." *Id.*

It thus came to a conclusion directly opposite to that reached by the First Circuit herein.

The First Circuit sought to avoid a direct conflict with *Trask* by asserting that in *Trask* the bankrupts had ceased operations while in this case the jury might have found that the Bankrupt's business was still being conducted as of the time of the alleged transfer (A-9), and that therefore the hiring of the former employees and solicitation of the former customers was "a transfer ... of the operating portion of the [Bankrupt's] business ...." (A-10).

That purported distinction, on the basis of the passage of one night,[6] is without substance. A debtor should not be regarded as a going concern "if at the time ... he was financially dead or mortally wounded." *In re Fred D. Jones Co.*, 268 Fed. 818, 819 (7th Cir. 1920), *appeal dismissed sub nom. Heldman* v. *Central Trust Company of Illinois*, 257 U.S. 664 (1921). A company which is not in fact an ongoing business cannot be viewed as having value as an ongoing business. *E.g.*, *Langham, Langston & Burnett* v. *Blanchard*, 246 F.2d 529, 532 (5th Cir. 1957); *In re Fred D. Jones, Co.*, *supra* 268 Fed. at 819; *In re Windor Industries, Inc.*, 459 F. Supp. 270, 276 (N.D. Tex. 1978).

The Bankrupt could not retain Otte as an employee and it could "retain" its other employees only by defrauding them and violating a criminal statute. *See* Mass. Gen. Laws Ch. 149, § 148 (1971). A company which cannot operate except by committing fraud and criminal conduct is not an ongoing business.

The decision of the Fifth Circuit in *Trask* v. *Susskind* represents a recognition of the reality of a business's demise. If

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[6] Otte was hired after 5:00 P.M. on April 22, 1970, when the Bankrupt knew "the ship was sinking", while the *Trask* employees were hired the day after the *Trask* bankrupts had ceased operations.

a business cannot pay its employees and service its customers, someone who hires those employees and solicits those customers does not thereby obtain "property" belonging to the defunct company. The First Circuit's holding to the contrary should be reversed.

IV. The Decision Below Will Make Officers And Employees Of Failing Businesses Unemployable.

The Petitioners have been subjected to substantial liability because they did not wait until the Bankrupt's employees had suffered the effects of unemployment fully before hiring them.

In this case, as in *Trask* v. *Susskind*, *supra*, a central consideration is the right of an employee of a bankrupt to work for another employer. A bankrupt should not be in a position to compel its at will employees to work for nothing, to refuse to work, or, without a covenant not to compete, to refuse to solicit former customers on behalf of a new employer. Nor should a new employer be punished for offering jobless employees jobs, or forced to wait an arbitrary period while its prospective employees swell the ranks of the unemployed. The Fifth Circuit in *Trask* firmly held that a former employee of a bankrupt is entitled to work for a new employer in the same business. The Courts of the Commonwealth of Massachusetts would have applied the same rule to the Bankrupt's employees. *See J.T. Healy & Son, Inc.* v. *James A. Murphy & Son, Inc.*, 357 Mass. 728, 740 (1970); *DiAngeles* v. *Scauzillo*, 287 Mass. 291, 295-96 (1934); *Padover* v. *Axelson*, 268 Mass. 148, 151-52 (1929).

The First Circuit, however, has now held that one who hires the employee of a failing company either cannot do so or can do so only at the risk and expense of defending an action such as this one. That holding will deny former employees of a bankrupt the ability to earn a living for a substantial period after their employer stops paying them.

A central purpose of the Bankruptcy Act and Code is to give debtors a fresh start. It should not be subverted into a means for giving a debtor's employees the cruel choice of either working for nothing or not working.

V. The Decision Of The Court Of Appeals For The First Circuit Is Contrary To The Language And Intent Of The Bankruptcy Act And Code.

Section 67(d)(2)(a) of the Bankruptcy Act, on which the Trustee's claim was based, makes voidable any transfer of property by a bankrupt within one year of bankruptcy, made without fair consideration and either made while the bankrupt was insolvent or which renders the bankrupt insolvent. The Bankruptcy Code contains a similar provision. 11 U.S.C. § 548 (1979).

The Trustee alleged that the Bankrupt transferred its employees, customers and goodwill to Watts on or after April 23, 1970. None of these items constituted property under the Bankruptcy Act because the Bankrupt did not have rights in these items recognizable under Section 67(d).

A fundamental element of "property" is the right to exclude others from its use. *Kaiser-Aetna* v. *United States*, 444 U.S. 164, 179-80 (1979). Even when something claimed to be "property" has been acquired or developed at substantial expense, it is not property unless the purported owner has a legal right to exclude others from using it. *International News Service* v. *Associated Press*, 248 U.S. 215, 250 (1919) (dissenting opinion by Brandeis, J., cited with approval by this Court in *Kaiser-Aetna* v. *United States*, *supra*, 444 U.S. at 180 n.11):

> An essential element of individual property is the legal right to exclude others from enjoying it .... [T]he fact

> that a product of the mind has cost its producer money and labor, and has a value for which others are willing to pay, is not sufficient to ensure to it this legal attribute of property.

U.S. at 250.

The purpose of the fraudulent transfer statute is to prevent "a bankrupt [from] depleting his estate just preceding his bankruptcy." *Mayo* v. *Pioneer Bank & Trust Co.*, 270 F.2d 823, 830 (5th Cir. 1959), *cert. denied*, 362 U.S. 962 (1960); *accord*, 4 *Collier on Bankruptcy*, ¶67.30 at 489 (14th ed. 1978). Detriment to the bankrupt's estate is the concern of Section 67(d). That a third party may be benefited by the bankrupt's ceasing to do business thus does not prove a fraudulent transfer. *In re Commodity Merchants, Inc.*, 538 F.2d 1260 (5th Cir. 1976). *See In re Portland Newspaper Publishing Co.*, 271 F. Supp. 395, 398, (D. Ore. 1967), *aff'd sub nom. Dubay* v. *Williams*, 417 F.2d 1277 (9th Cir. 1969). *See also, Thomas* v. *Gulfway Shopping Center, Inc.*, 320 F. Supp. 756, 762 (S.D. Tex. 1970). A crucial element in determining whether "property" of the Bankrupt was transferred is therefore whether the Bankrupt's estate was diminished, that is, whether the alleged property could have been excluded from others' use and retained long enough to be available to satisfy creditors.

The Bankrupt was rendered financially incapable of retaining Otte or its employees, or in fact of lawfully continuing in operation, by April 22, 1970. It could not lawfully exclude others from hiring its employees or servicing its customers. The Bankrupt's estate was not diminished as the result of Watts hiring Otte and the former employees nor by Otte's solicitation of former customers. Because there was no diminution of the Bankrupt's estate, it necessarily follows that hiring the Bankrupt's employees and servicing its customers was not a

fraudulent transfer. The First Circuit's holding to the contrary thus was inconsistent with the language and policy of the Bankruptcy Act and the Bankruptcy Code.

Conclusion

For the reasons stated above, a writ of certiorari should issue to review the judgment and opinion of the United States Court of Appeals for the First Circuit entered in this proceeding on July 19, 1982.

DATED: November 3, 1982

Respectfully submitted,

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